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TRANSMITTAL SLIP		DATE <i>15 May</i>	
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REMARKS:  <i>New Version</i> <i>w/o request</i>			
FROM: <i>NIO/ECON</i>			
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FORM NO. 241  
1 FEB 56

REPLACES FORM 36-8  
WHICH MAY BE USED.

(47)

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## ROUTING AND RECORD SHEET

SUBJECT: (Optional)

Memo to LtGEN Perroots on DIA Request for Dollar Costing Estimate

FROM:

MGen Frank B. Horton III, USAF  
Chairman, National Intelligence Council

EXTENSION

NO.

NIC 02112-87

DATE

15 May 1987

TO: (Officer designation, room number, and building)

DATE

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COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)

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This is in response to your note on Perroots' request. It is a mild reclamation + suggests a compromise. It sounds reasonable to me.

Jim H



P-205-1R

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 02112-87  
15 May 1987

MEMORANDUM FOR: Acting Director of Central Intelligence

FROM: Maj Gen Frank B. Horton III, USAF  
Chairman

SUBJECT: DIA Request for Dollar Costing Estimate

1. Action: your approval and signature on the attached letter to General Perroots agreeing to an NFIB-approved IIM on the methodology for dollar costing of military expenditures. The letter does not, however, propose to cover results in the IIM, or alternatively to cover results as part of an extended set of joint CIA-DIA produced, Military Board approved papers. The latter procedure, we believe, should be reserved as it is today for those exceptional products aimed at audiences that clearly require a coordinated administration view such as our annual joint JEC testimony. Results, for the most part, would continue to be published by individual agencies in papers that would be based on the proposed IIM.

2. Background. The Perroots request for Community papers asked for (a) Community approval on a paper on the methodology of dollar costing including the strengths, weaknesses, and caveats of the techniques and (b) Community agreed results of a comparison of NATO-Warsaw Pact defense costs using these techniques. General Durkin told me that Perroots was primarily after a Community paper on methodology rather than one on results. Hence, by agreeing to an IIM on dollar costing methodology only, I believe we are responding adequately to the substance of the request.

3. As to the possibility of expanding joint CIA-DIA production and Military Costing Review Board approval of results-oriented dollar costing papers, Deane Hoffmann and I believe in our consultations with SOVA that we should continue to allow individual agency production of most results-oriented papers. We could still serve the purpose of enhancing their consistency and assuring their caveating by using the forthcoming IIM as a mandatory basis for doing the work and putting it in proper context. To go further and insist on joint production and approval of such papers in other than special cases agreed between DIA and CIA like the JEC testimony, we believe, would do a disservice to competitive analysis while hampering the production process.

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SUBJECT: DIA Request for Dollar Costing Estimate

4. Thus, unless you feel strongly about expanded joint production and approval of such papers, propose that we proceed as indicated and that you sign out the attached. If you wish to discuss the issue of joint analyses further, however, I recommend you, I, Deane Hoffmann, and  DI/SOVA, get together to air further the possible benefits and potential pitfalls.

25X1

Very respectfully,



MG Frank B. Horton III

Attachment:

Memo to LtGEN Perroots, D/DIA

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SUBJECT: DIA Request for Dollar Costing Estimate

NIO/Econ/DHOFFMANN:rr



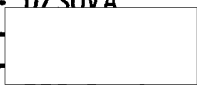

15 May 1987

NIC 02112-87

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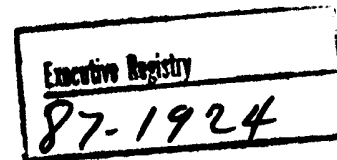
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The Deputy Director of Central Intelligence

Washington, D.C. 20505



18 MAY 1987

MEMORANDUM FOR: Lieutenant General Leonard H. Perroots, USAF  
Director, Defense Intelligence Agency

SUBJECT: Request for National Intelligence Estimate on Dollar  
Costing of Warsaw Pact Military Spending

1. I agree with you that dollar cost comparisons of Soviet-US and NATO-Warsaw Pact defense costs, while useful, have limitations and are frequently misunderstood by policymakers. Hence, a paper that clearly lays out the approved methodology, its alternatives, their strengths and limitations, and the caveats that should accompany their use, would be a useful piece as background for our readers. I would include in this paper our recent addition to the dollar costing methodology for non-US NATO countries to account for currency fluctuations that was recently briefed to our joint CIA/DIA Military Costing Review Board and to you and your staff.

2. I believe such an overview paper should be drafted jointly by CIA and DIA, sent to the joint Military Costing Review Board for approval of the portrayal of the methodology, its alternatives, and appropriate caveats, then more widely coordinated throughout the Intelligence Community and reviewed by the NFIB before being published as an Interagency Intelligence Memorandum. I would ask the NIO for Economics to oversee the process. It is important to note that the joint Board-approved dollar cost estimating techniques that would be highlighted in this paper were thoroughly reviewed in 1983 by a group of outside experts, the DCI's Military-Economic Advisory Panel (MEAP). Only one relatively minor extension has been made in the methodology since then, the one applying to non-US NATO countries noted above, and these experts have been asked to review this change.

3. Your letter also suggests that the proposed paper include results of the application of the methodology in the context of a NATO-Warsaw Pact spending comparison. I would prefer to leave to other papers the detailed application of the methodology, on an as needed basis, although the paper in question would no doubt have to illustrate the points it makes. I believe such largely technical results-oriented papers should continue to be produced primarily by the individual agencies, basing their work on the

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methodologies and caveating their results using the language that will appear in the proposed IIM. This strikes the right balance between Community consistency and competitive analysis, it seems to me. I would reserve for joint production and Costing Board approval those especially significant papers that we agree should be joint given their audiences. currently the annual JEC testimony on the Soviet economy and [redacted]  
[redacted] NATO-Warsaw Pact Defense costs.

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/s/ Robert M. Gates

Robert M. Gates  
Acting Director

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CONTROL NO. \_\_\_\_\_

CROSS REF: \_\_\_\_\_

PRIOR PAPERS ON THIS SUBJECT: NO YES

PRIOR CORRES SENT TO: \_\_\_\_\_

OTHER COMMENTS: \_\_\_\_\_

*Log -  
Pres + all ltr (except  
ERD) returned to  
G/NIC for revision*

EXECUTIVE REGISTRY FILE NO: \_\_\_\_\_

CROSS REF: \_\_\_\_\_

*P205-12*

CONFIDENTIAL  
The Director of Central Intelligence  
Washington, D.C. 20505

National Intelligence Council

NIC 02112-87  
14 May 1987

MEMORANDUM FOR: Acting Director of Central Intelligence

FROM: Maj Gen Frank B. Horton III, USAF  
Chairman

SUBJECT: DIA Request for Dollar Costing Estimate

1. Action: your approval and signature on the attached letter to General Perroots agreeing to an NFIB-approved IIM on the methodology for dollar costing of military expenditures. The letter does not, however, agree to expanded joint CIA-DIA production and approval of papers using dollar estimates of Soviet programs, as you suggested in your response to me. After discussions with SOVA, Deane Hoffmann and I feel establishing such a procedure as standard for such papers would be unnecessarily burdensome and, indeed, counterproductive to the intelligence process.

2. Background. The Perroots request for Community papers asked for (a) Community approval on a paper on the methodology of dollar costing including the strengths and weaknesses of the techniques and (b) Community agreed results on a comparison of NATO-Warsaw Pact defense costs. General Durkin told me that Perroots was primarily after a Community paper on dollar costing rather than one on results. Hence, by agreeing to an IIM on dollar costing methodology, I believe we are responding adequately to the substance of the request.

3. As to the possibility of expanding joint CIA-DIA production and Military Costing Review Board approval of results-oriented dollar costing papers, we see pitfalls. As you know, most results-oriented costing papers today are produced by individual agencies. And, as you also are aware, the CIA-DIA Board today focuses on approval of the methodology, not results. It is tasked with approving text and results of only two papers----the annual JEC testimony on the Soviet economy and [redacted]

[redacted] NATO-Warsaw Pact defense costs. These papers clearly are unique in needing to present a coordinated Administration viewpoint. To expand the list of joint papers and to extend the Board's role to the approval of all costing papers produced by individual agencies or jointly, would hamper the production of competitive analyses with little compensating gain.

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SUBJECT: DIA Request for Dollar Costing Estimate

- CIA produces roughly five additional papers per year that rely heavily on the results of dollar costing, and several more that use it to some degree.
- By agreeing to prepare such papers jointly with DIA as a standard procedure, CIA would be limited by DIA's capabilities in the area. (Only one or two DIA analysts now work on dollar costing.)
- DIA produces a smaller, but not insignificant, number of such papers annually and presumably also would not want to have joint production of many of these.
- To serve the purpose of enhancing the degree of consistency of these papers, the forthcoming IIM on methodology should serve well.
- To go farther and insist on joint production and approval would do disservice to competitive analysis while hampering the production process.

Thus, unless you feel strongly about joint production and approval of such papers, Deane and I think we should restrict the joint approach to the currently agreed efforts. For other papers, we should continue to allow individual Agency publication, thus allowing for the airing of divergent points of view.

4. If you wish to discuss the issue of joint analyses, I suggest you, I, Deane Hoffmann, and   DI/SOVA, get together to air further the possible benefits and potential pitfalls.

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MGen Frank B. Horton III

Attachment:  
Memo to LtGEN Perroots, D/DIA

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SUBJECT: DIA Request for Dollar Costing Estimate

NIO/Econ/DHOFFMANN:rr( [redacted]

14 May 1987

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The Deputy Director of Central Intelligence

Washington, D. C. 20505

Executive Registry

87-1924

MEMORANDUM FOR: Lieutenant General Leonard H. Perroots, USAF  
Director, Defense Intelligence Agency

SUBJECT: Request for National Intelligence Estimate on Dollar  
Costing of Warsaw Pact Military Spending

1. I agree with you that dollar cost comparisons of Soviet-US and NATO-Warsaw Pact defense costs, while useful, have limitations and are frequently misunderstood by policymakers. Hence, a paper that clearly lays out the approved methodology, its alternatives, and their strengths and limitations would be a useful piece as background for our readers. I would include in this paper our recent change to the dollar costing methodology for non-US NATO countries to account for currency fluctuations that was recently briefed to our joint CIA/DIA Military Costing Review Board and to you and your staff. I would prefer to leave to other papers the detailed application of the methodology, on an as needed basis, although the paper in question would no doubt have to illustrate the points it makes.

2. I believe such an overview paper should be drafted jointly by CIA and DIA, sent to the joint Military Costing Review Board for approval of the portrayal of the methodology and its alternatives, then more widely coordinated throughout the Intelligence Community and reviewed by the NFIB before being published as an Interagency Intelligence Memorandum. I would ask the NIO for Economics to oversee the process. It is important to note that the joint Board-approved dollar cost estimating techniques that would be highlighted in this paper were thoroughly reviewed in 1983 by a group of outside experts, the DCI's Military-Economic Advisory Panel (MEAP). Only one relatively minor extension has been made in the methodology since then, the one applying to non-US NATO countries noted above, and these experts have been asked to review this change.

3. Your letter also suggests that the paper on dollar costing methodology include results of analysis in the context of a NATO-Warsaw Pact spending comparison. I believe we should leave such largely technical

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SUBJECT: Request for National Intelligence Estimate on Dollar Costing of  
Warsaw Pact Military Spending

papers to the individual agencies, basing their work on the methodologies  
that will appear in the proposed IIM. This strikes the right balance  
between Community consistency and competitive analysis, it seems to me. I  
would reserve for joint production and Board approval those especially  
significant papers that we agree should be joint given their audiences.  
currently the annual JEC testimony on the Soviet economy and [redacted]  
[redacted] NATO-Warsaw Pact Defense costs.

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Robert M. Gates  
Acting Director

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## DEFENSE INTELLIGENCE AGENCY

WASHINGTON, D.C. 20340- 6134

Executive Registry

87-1607X

17 APR 1987

U-0675/DE-1

## MEMORANDUM FOR THE DIRECTOR OF CENTRAL INTELLIGENCE

**SUBJECT: Request for National Intelligence Estimate on Dollar Costing of Warsaw Pact Military Spending**

1. The current methodology used for costing Soviet and non-Soviet Warsaw Pact (NSWP) defense efforts in dollar terms has been in use for a number of years. It has required considerable effort and resources, mostly on the part of CIA, but to some extent on the part of other agencies as well. Given this investment, we believe that now is an appropriate time to take a fresh look at this direct costing methodology, particularly as a new generation of weapons begins production and requires new costing efforts.

2. There has been increasing use of dollar cost comparisons of Soviet-U.S. and NATO-Warsaw Pact defense costs, but often with insufficient understanding on the part of policymakers as to how and why we do such costing and its limitations. A definitive document on dollar costing would serve to clarify a number of issues.

a. It would provide community agreed results of such comparisons as NATO and Warsaw Pact costs and Soviet and U.S. defense costs.

b. It would provide the strengths and weaknesses of the methodology, the definitions (i.e., inclusions and omissions) used in making the estimates, the limitations of the data itself, the confidence levels associated with the various parts of the methodology making up the estimate, and the caveats on the use of the estimates.

c. It would address the detail of the methodology itself, to include such items as the costs of the equipment, the last time such items were costed, and the various ways in which different items are actually costed.

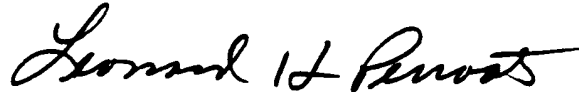
d. It could also provide a review of the non-U.S. NATO costs and their applicability to these comparisons.

3. The review of the methodology would serve as a basis for an assessment of our ability to cost the next generation of weapons systems, and to identify the extent of the gaps in our knowledge of weapon systems.

4. Through the process of developing our own budget proposals, we expect that policymakers will rely even more on dollar cost comparisons. The usefulness of such comparisons would be greatly

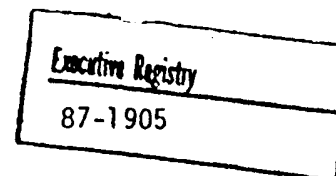
enhanced if we could provide a better understanding of the methodology involved and the limitations of the numbers contained in the estimates.

5. DIA strongly recommends that an estimate on Soviet and NSWP dollar costing be undertaken, as well as a review of non-U.S. NATO costs. DIA is prepared to provide full support to this effort. In view of the importance of the issue, we hope that work on this estimate could begin soon.



**LEONARD H. PERBOOTS**  
Lieutenant General, USAF  
Director





12 May 1987

MEMORANDUM FOR: Chairman, National Intelligence Council  
FROM: Acting Director of Central Intelligence  
SUBJECT: DIA Request for Dollar Costing Estimate

1. I am willing for a paper on costing methodology to be blessed by the NFIB. It seems to me it should probably be prepared by CIA and DIA jointly (not drafted by CIA alone), approved by the Joint Costing Board and, finally, have a laying on of hands by the NFIB. For methodological papers, this is not an unreasonable approach. Substantive papers, however, would be prepared jointly by CIA and DIA and published jointly after the blessing of the Costing Board.

2. Finally, it seems to me the most even handed approach would be to have the enterprise carried out under the leadership of someone agreeable to both CIA and DIA or under an NIO.

3. In short, I don't have serious problems with General Perroots' request that the basic methodological approaches have some Community endorsement.

4. Are there problems with the approach I have outlined?



Robert M. Gates

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 01899-87  
8 May 1987

MEMORANDUM FOR: ADCI

FROM: Maj Gen Frank B. Horton III, USAF  
Chairman

SUBJECT: DIA Request for Dollar Costing Estimate

1. General Perroots' request for a Community Estimate on dollar costing Pact and non-US NATO expenditures raises a question of the wisdom of tasking the Community with a largely technical topic which is already adequately handled by the joint CIA-DIA Military Costing Review Board.

-- Per our discussion with you, we propose that CIA be tasked to do a methodology paper in cooperation with DIA, run it by the joint Board and the MEAP, and publish it jointly with DIA. Results would be left for other papers to address.

2. Our check with Major General Durkin, DIA/VP, indicates that while DIA would consider such a proposal, his initial reaction would be to still prefer at least an NFIB-approved IIM on the methodology of dollar costing. It is not clear how General Perroots would react.

-- Durkin indicates that DIA feels a Community blessing on the description of and rationale for alternative costing methodologies would serve as a useful baseline for future work and a basis for defense of that work. He indicated that results are less central to their request.

3. According to SOVA, the DIA request came in the wake of a SOVA briefing to General Perroots on a CIA-produced draft assessment that the non-US NATO countries (and US/NATO total) are outspending the non-Soviet Warsaw Pact (and Soviet/Pact total) on defense when measured in dollar terms.

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SUBJECT: DIA Request for Dollar Costing Estimate

- Despite some concerns that briefing generated within DIA, we understand that members of the CIA/DIA Board were briefed on the change in the approved dollar costing methodology to accommodate non-US NATO countries that was used in the briefing. We could and should include this change in methodology in the proposed overview paper, and review the change with the MEAP.

4. While Durkin did not cite the precedent, we have recently completed another paper on costing methodology and results, in this case on Soviet Arms Transfers, which was about to be forwarded for your approval prior to Community coordination as an IIM.

- In our view, the methodology developed in this paper is highly technical and, in retrospect, probably should also be referred to the Board, reviewed by the MEAP, and published as a CIA paper vice an IIM if we are to stick with and be consistent with our proposal on the DIA request.

5. Additionally, I suggest we in the NIC develop and coordinate a concise synopsis of agreed language relating to the benefits and problems of dollar costing. We would propose that such language be included prominently in any future estimates produced, whether Agency, joint, or Community, which use military costing methodologies.

6. It appears we are on firm ground in referring Perroots' request to the Joint Costing Board.

- The Board has a valued tradition of approving costing methodologies.
- The basic methodologies were not only approved by the Board, but also by a group of highly respected non-government analysts, the MEAP; any additions or revisions should take a similar route.
- The Board does have precedent for reviewing papers since it approves the annual JEC testimony on the Soviet economy and

- To elevate such papers from the Board to the Community at once dilutes the charter of the Board and gives additional impetus to a less than optimum form of analysis which we would like to discourage.

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SUBJECT: DIA Request for Dollar Costing Estimate

7. Thus we propose you sign the attached. The letter outlines our proposal and suggests that if General Perroots disagrees, he bring the matter before NFIB. We would put the proposed methodology paper, the draft IIM on arms transfers, and the draft CIA study on non-US NATO/non-Soviet Pact on hold until we hear from General Perroots, but in the meantime we would have the MEAP review the new methodologies contained in the draft IIM and the CIA paper.

  
MGen Frank B. Horton III

Attachments:

- A. Memo to LtGEN Perroots, D/DIA
- B. Key Judgments and Preface of IIA: Comparison of Warsaw Pact and NATO Defense Activities, 1976-86
- C. Scope Note and Key Judgments of IIM: The Estimated Value of Soviet-Third World Arms Transfers: A New Methodology,

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SUBJECT: DIA Request for Dollar Costing Estimate

NIO/Econ/DHOFFMANN

8 May 1987

NIC 01899-87

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The Deputy Director of Central Intelligence

Washington, D.C. 20505

Executive Registry

87-160711

MEMORANDUM FOR: Lieutenant General Leonard H. Perroots, USAF  
Director, Defense Intelligence Agency

SUBJECT: Request for National Intelligence Estimate on Dollar  
Costing of Warsaw Pact Military Spending

1. I agree with you that dollar cost comparisons of Soviet-US and NATO-Warsaw Pact defense costs, while useful, have limitations and are frequently misunderstood by policymakers. Hence, a paper that clearly lays out the approved methodology, its alternatives, and their strengths and limitations would be a useful piece as background for our readers. I would include in this paper our recent change to the dollar costing methodology for non-US NATO countries to account for currency fluctuations that was recently briefed to our joint CIA/DIA Military Costing Review Board and to you and your staff. I would prefer to leave to other papers the detailed application of the methodology, on an as needed basis, although the paper in question would no doubt have to illustrate the points it makes.

2. I believe such an overview paper should be drafted by CIA, working with DIA personnel you designate, and sent to the Military Costing Review Board for approval of the portrayal of the methodology and its alternatives before being published as a joint CIA/DIA product rather than by the Community.

- As you are aware, the Board was established in 1974 to review methodologies on dollar costing of Soviet military spending; and it periodically approves the costing of individual items as well as any changes in the methodology.
  - The Board also has a history of reviewing costing related papers; it approves annually the JEC testimony on the Soviet economy and
- 
- To elevate such papers to the Community would, in my view, dilute the charter of the Board and give additional impetus to a less than optimum form of analysis, one the Board is well suited to work.

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SUBJECT: Request for National Intelligence Estimate on Dollar Costing of Warsaw Pact Military Spending

3. It is important to note that Board-approved dollar costs estimating techniques were thoroughly reviewed in 1983 by a group of outside experts, the DCI's Military-Economic Advisory Panel (MEAP). Only one relatively minor change has been made in the methodology since then, the one applying to non-US NATO countries noted above, and I am asking that these experts review this change when they meet later this month. Because of the limitations of dollar costing, I suggest the NIC develop and coordinate a concise summary of the benefits and problems of such methodology. This language would be included prominently in any Agency, joint, or Community product using this methodology.

4. It seems to me we should agree to continue to allow the Board to be the primary referee on highly technical costing papers where competence exists solely within DIA and CIA. In this vein, the draft IIM I just received for pre-coordination review, The Estimated Value of Soviet-Third World Arms Transfers: A New Methodology, which covers the revised approach for measuring the dollar value of arms transfers, seems also clearly within the competence of the Military Cost Review Board for review of the methodology, and the MEAP for a second check. Hence, I am inclined to refer it to the Board and the MEAP for their consideration as well, before being published by CIA instead of the Community. I would similarly delay publication of the CIA paper on non-US NATO and non-Soviet Pact expenditures until such review of its new methodology is completed. I would propose that both of these papers make reference to DIA/CIA joint Board agreement on the methodology on which they are based, with the NIC-developed caveat prominently displayed.

5. I do not wish, however, to make a unilateral decision on an issue that you may feel is appropriate for NFIB consideration. If you want to pursue it, we could take up this question at the next NFIB, asking NFIB to recommend criteria for Community review of technical military costing papers such as these and to address the specific question of whether any of the papers addressed above meet these criteria. On the other hand, if you agree with my approach, let me know and we shall proceed.

Robert M. Gates  
Acting Director

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Next 17 Page(s) In Document Denied



## DEFENSE INTELLIGENCE AGENCY

WASHINGTON, D.C. 20340 6134

Executive Registry

87-1607X

17 APR 1987

U-0675/DE-1

## MEMORANDUM FOR THE DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT: Request for National Intelligence Estimate on Dollar Costing of Warsaw Pact Military Spending

1. The current methodology used for costing Soviet and non-Soviet Warsaw Pact (NSWP) defense efforts in dollar terms has been in use for a number of years. It has required considerable effort and resources, mostly on the part of CIA, but to some extent on the part of other agencies as well. Given this investment, we believe that now is an appropriate time to take a fresh look at this direct costing methodology, particularly as a new generation of weapons begins production and requires new costing efforts.

2. There has been increasing use of dollar cost comparisons of Soviet-U.S. and NATO-Warsaw Pact defense costs, but often with insufficient understanding on the part of policymakers as to how and why we do such costing and its limitations. A definitive document on dollar costing would serve to clarify a number of issues.

a. It would provide community agreed results of such comparisons as NATO and Warsaw Pact costs and Soviet and U.S. defense costs.

b. It would provide the strengths and weaknesses of the methodology, the definitions (i.e., inclusions and omissions) used in making the estimates, the limitations of the data itself, the confidence levels associated with the various parts of the methodology making up the estimate, and the caveats on the use of the estimates.

c. It would address the detail of the methodology itself, to include such items as the costs of the equipment, the last time such items were costed, and the various ways in which different items are actually costed.

d. It could also provide a review of the non-U.S. NATO costs and their applicability to these comparisons.

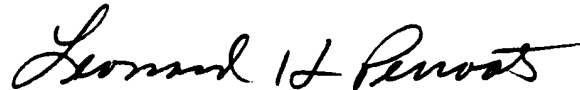
3. The review of the methodology would serve as a basis for an assessment of our ability to cost the next generation of weapons systems, and to identify the extent of the gaps in our knowledge of weapon systems.

4. Through the process of developing our own budget proposals, we expect that policymakers will rely even more on dollar cost comparisons. The usefulness of such comparisons would be greatly

REFERENCE

enhanced if we could provide a better understanding of the methodology involved and the limitations of the numbers contained in the estimates.

5. DIA strongly recommends that an estimate on Soviet and NSWP dollar costing be undertaken, as well as a review of non-U.S. NATO costs. DIA is prepared to provide full support to this effort. In view of the importance of the issue, we hope that work on this estimate could begin soon.

A handwritten signature in cursive script, reading "Leonard H. Perroots".

**LEONARD H. PERROOTS**  
Lieutenant General, USAF  
Director